An Introduction to Tax Treaties

Françoise L.M Hendy
International Treaty Negotiator
(Tax, Investment, Trade)
Attorney-at-Law

What is a TREATY ?

- **A 'Proof' and 'Product' of Diplomacy**
- **A Contract**

concluded between Sovereign States

in written form

governed by Public International Law

whether in one or more documents

regardless of its description

Legal Effect of a TREATY ?

- **Contracting State Parties**

  Dualism
  Monism

- **Third States (Non-Contracting State Parties)**

- **Territorial Application**

- **Succession**

What is a TAX TREATY ?

An agreement in writing between sovereign states governed by public international law which sets out the rights and responsibilities of the contracting states in respect of matters of **international taxation** including the exchange of tax information and the prevention of fiscal evasion.

International Taxation: A Fiction!

Under International law there does not exist an overarching body of 'international tax law' through which international prescriptive and enforcement powers in relation to the imposition of tax has been recognized or accepted by the community of states.

The right to impose tax and the administration of a taxation system along with the authority to impose sanction for breach of the obligation is a function of domestic law.

International Taxation therefore merely refers to the 'foreign' elements of a country's domestic tax system which expose latent or patent conflicts with another country's tax system; warrants a joint and sustained response by the countries whose national interests are affected; and where unilateral remedies may not adequately or definitely resolve the problems in the application of the domestic tax law.

Goals of International Taxation Rules (1)

- **Avoidance of Double Taxation**

  The juridical meaning of 'double taxation' describes the concept where taxation occurs in two or more jurisdictions in respect of the same object of tax and exercised with respect to the same tax subject for the same taxable period

- **Types of double taxation**

✓ Source-Source
✓ Residence-Source
✓ Source-Residence

Goals of International Taxation Rules: (2)

Fairness

- **Inter-state justice (Protection of tax-base)**

  Transparency
  Exchange of Tax Information
  Prevention of Fiscal Evasion

- **Taxpayer Treatment**

  Non-discriminatory treatment of taxpayer liability without reference to the <u>source</u> of the income

  Tax liability should be contingent on tax payers ability to pay.

Goals of International Taxation Rules: (3)

Competiveness

- National
- Industry
- Firm
- Individual

Goals of International Taxation: (4)

Neutrality

- A fundamental tax policy principle.

  It requires that economic processes should not be affected by external influences such as taxation. In this way it is argued productivity will be highest when income producing factors are distributed by the market preference without public interference. Neutral equates to efficiency and tax laws that do not interfere with factor distribution by market forces are regarded as neutral.

- Capital Import vs. Export Neutrality

The Rules of International Taxation: Overview

The purpose of tax treaties is to codify the rules that will be applied to resolve the conflicts that arise as a result of juridical double taxation.

In this respect they are three types of these distributive rules: source, assignment and relief.

The Rules of International Taxation (1)

Source

Customary international law provides that a country has the primary right to tax income that has its source in that country.

Under the rules of source the tax objects over which the State has the principal though not exclusive right to tax include

immoveable property; industrial or business profits and professional services; shipping and air transport; dividend, interest payments and directors' fees; employment services; artistes, entertainers and sportspersons; and government salaries and pensions

The Rules of International Taxation (2)

Assignment

Assignment rules allocate either an exclusive or limited taxing right to countries using one or more of the following distributive principles on different income sources: the exclusive right to tax is conferred on the state of source of the tax object; the source country can reserve the right to limit or share its taxation right of the object; the source country may tax fully even in the absence of an exclusive tax right; and the exclusive right to taxation is with the country where the tax subject resides.

The Rules of International Taxation (3)

Relief

The content of these rules also provide mechanisms to eliminate or mitigate juridical double taxation when it arises by: the exemption method whereby full exemption or exemption with progression is provided in respect of the taxes suffered in the other jurisdiction; full or ordinary credit for the tax paid is provided at the marginal or average tax rate; of limited modern-day use is the tax sparing method where a tax sparing credit is granted by the residence country for foreign taxes that for some reason were not actually paid under the country's normal tax rules.

Key Elements of a Tax Treaty: (1)

Scope and Coverage

- Persons Covered

  Individual
  Company
  Other body of person

- Taxes Covered

  Income (Corporate , premium, petroleum winnings)
  Capital Gains

Key Elements of a Tax Treaty: (2)

Residency

- Not citizenship
- Not nationality
- 'Liable to tax'

✓ Residence
  - Incorporation
  - Central Management and Control

✓ Domicile
  - Intention + Stay + Notification

✓ Place of management
  - Permanent Establishment

✓ Any other similar criterion

Key Elements of a Tax Treaty: (3)

Apportionment of Taxing Rights

- Business Income
- Shipping and International Transport
- Associated enterprises
- Professionals
- Investment Income
  - Dividends
  - Interest
  - Royalties
- Capital gains
- Income from immoveable property
- Income from employment
- Pensions and other remuneration
- Professors and teachers
- Students and trainees
- Treatment of Entertainers and sportspersons
- Other income

Key Elements of a Tax Treaty: (4)

Methods of Avoiding Double Taxation

- Tax Sparing
- Credit Method
- Exemption

Key Elements of a Tax Treaty: (5)

Prevention of Fiscal Evasion

- Avoidance and evasion distinguished
- Denial of treaty benefits
  - *Application of domestic GAAR*
  - *Limitation of Benefits provisions*
- Administrative co-operation
  - *Competent Authority Procedure*
  - *Exchange of tax information*
  - *Non-discrimination*

franhendy's OFFSHORE blog
E-Learning
www.franhendy.com

fh@francoisehendy.com